

# Letter of Transmittal



STATE OF WASHINGTON

## DEPARTMENT OF RETIREMENT SYSTEMS

P.O. Box 48380 • Olympia, Washington 98504-8380

December 31, 2004

**The Honorable Gary Locke, Governor**  
**Members of the Fifty-Eighth Legislature**  
**Members of the Select Committee on Pension Policy**  
 State of Washington  
 Olympia, Washington 98504

We are pleased to present to you the Department of Retirement Systems' Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2004. This CAFR is designed to comply with the requirements of chapters 41.50.050(4) RCW, 41.50.780(9) RCW, and 41.04.630(2) RCW.

Responsibility for the accuracy of the data and the fairness and completeness of this presentation, including all disclosures, rests with the management of the Department of Retirement Systems (DRS). To the best of our knowledge, the enclosed data is accurate in all material respects and is reported in a manner designed to provide a fair representation of the financial position and results of the operations of the department.

This report consists of five sections:

- (1) The Introductory Section, which contains a message from the Director of DRS, this letter of transmittal, which is designed to complement the Management's Discussion and Analysis and which presents a narrative introduction, overview and analysis of the financial statements, and information about the agency's administrative structure and operations;
- (2) The Financial Section, which contains the report of the independent auditors, Management's Discussion and Analysis, the financial statements, the notes to the financial statements, required supplementary information, and additional financial information;
- (3) The Investment Section, which contains the report of the Washington State Investment Board (WSIB), investment policies, results, associated fees and commissions, and additional investment information;
- (4) The Actuarial Section, which contains the report of the State Actuary, a summary of actuarial assumptions and methods, and actuarial schedules and data; and
- (5) The Statistical Section, which contains significant data pertaining to the retirement systems.

### Agency Description and History

DRS administers seven statewide public employee retirement systems, which are comprised of 11 defined benefit pension plans and three combination defined benefit/defined contribution plans. The purpose of DRS is to administer pension plan coverage for state employees, teachers and classified educational employees, law enforcement officers and firefighters, and other employees of participating political subdivisions. As of June 30, 2004, there were 1,274 covered employers participating in multiple systems and/or plans administered by DRS. The eligibility requirements and provisions of each plan can be found in Note 2 of the Notes to the Financial Statements. DRS also administers a deferred compensation program and a dependent care reimbursement program. Additionally, DRS is responsible for all accounting and reporting services for the Judicial Retirement Account (JRA), which is a defined contribution pension plan administered by the State of Washington Administrative Office of the Courts.

The Washington State Legislature created the Department of Retirement Systems in 1976 to administer the Public Employees' (PERS), Teachers' (TRS), Law Enforcement Officers' and Fire Fighters' (LEOFF), Washington State Patrol (WSPRS), and Judicial (JRS) retirement systems, and the Judges' Retirement Fund (Judges).

Significant events in DRS history are listed below:

#### **1930s-1940s**

The PERS, TRS, WSPRS, Judges and many local police and firefighters' retirement systems were created.

#### **1950s-1960s**

Independent administration of individual retirement systems continued.

#### **1960s-1970s**

Local police and firefighters' retirement systems were consolidated into LEOFF.

#### **1976**

The Department of Retirement Systems was created to administer state retirement systems. The Office of the State Actuary was created to provide pension cost estimates.

#### **1977**

PERS Plan 2, TRS Plan 2, and LEOFF Plan 2 were created.

#### **1981**

The State Investment Board was created to handle investment of all state trust funds.

#### **1987**

The Joint Committee on Pension Policy was created.

#### **1995**

TRS Plan 3 was created effective July 1, 1996.

#### **1996**

The state Deferred Compensation and Dependent Care programs were transferred to DRS. DRS assumed accounting and reporting responsibility for the Judicial Retirement Account (JRA) defined contribution plan

#### **1998**

School Employees' Retirement System (SERS) Plans 2 and 3 were created effective September 1, 2000.

The Pension Funding Council was created.

#### **1999**

PERS Plan 3 was created effective March 1, 2002, for state and higher education employees, and effective September 1, 2002, for local government employees.

#### **2001**

WSPRS Plan 2 was created effective January 1, 2003.

#### **2003**

The Joint Committee on Pension Policy became the Select Committee on Pension Policy effective July 27, 2003.

The LEOFF 2 Board was established effective July 1, 2003.

#### **2004**

Public Safety Employees' Retirement System (PSERS) was created effective July 1, 2006.

### **Accounting System and Internal Control**

This report has been prepared to conform with the principles of accounting and reporting established by the Governmental Accounting Standards Board (GASB). The basic financial statements are presented in accordance with guidelines established by GASB Statement No. 25, *Financial Reporting for Defined Benefit Plans*, and other GASB statements, as appropriate. Specific accounting treatments are detailed in the Notes to the Financial Statements found in the Financial Section of this report.

In June 1999, the GASB issued Statement No. 34, *Basic Financial Statements-Management's Discussion and Analysis-for State and Local Governments* (GASB 34). In June 2001, the GASB issued Statement No. 37, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments: Omnibus*, which amended certain provisions of GASB 34. Effective for Fiscal Year 2002 reporting, DRS implemented the provisions of GASB 34. GASB 34 had no monetary impact on the financial statements of DRS, but did require additional disclosure. As a result of the implementation of GASB 34, the Management's Discussion and Analysis has been included as required supplementary information and precedes the financial statements.

Management is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the government are protected from loss, theft, or misuse, and to ensure that adequate accounting data are compiled to allow for the preparation of financial statements in conformity with generally accepted accounting principles. The internal control structure is designed to provide reasonable, but not absolute, assurance that these objectives are met. The concept of reasonable assurance recognizes that: (1) the cost of a control should not exceed the benefits likely to be derived, and (2) the valuation of costs and benefits requires estimates and judgments by management. In addition, budgetary controls are maintained by the Office of Financial Management and the Washington State Legislature.

### Additions To Pension Plan Net Assets

The primary sources of additions for the retirement trust funds include contributions from employers, active system members, the state, and investment earnings. The main sources of additions for the deferred compensation plan include participant contributions and investment earnings. Total additions to the retirement trust funds and the deferred compensation plan for Fiscal Year 2004 amounted to \$7,336.6 million, an increase of \$4,386.7 million from Fiscal Year 2003. The following schedule is a summary of the additions to the pension trust funds for the years ended June 30, 2004, and June 30, 2003.

(dollars in millions)		
<b>Additions to</b>	<b>Fiscal Year</b>	<b>Fiscal Year</b>
<b>Plan Net Assets</b>	<b>2004</b>	<b>2003</b>
Retirement Contributions	\$ 703.0	\$ 616.2
Deferred Compensation		
Participant Contributions	147.6	135.9
Net Investment Income	6,429.7	1,554.0
Charges for Services	28.0	27.6
Transfers From Pension Plans	25.4	614.6
Other Additions	2.9	1.6
<b>Total</b>	<b>\$7,336.6</b>	<b>\$2,949.9</b>

The increase in total pension trust fund additions resulted primarily from an increase in net investment income. The increase in net investment income was the result of improved

investment market conditions and performance. The increases and decreases between current year and prior year additions are discussed in more detail in the Management's Discussion and Analysis, which is presented on pages 28-32 in the Financial Section of this report.

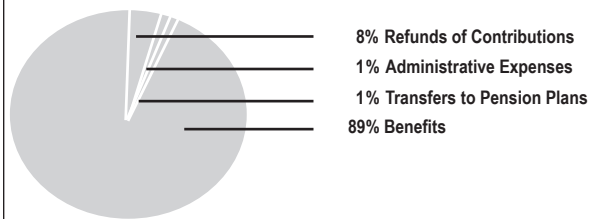
### Deductions To Pension Plan Net Assets

The primary deductions for the retirement trust funds include the payment of benefits to retirees and beneficiaries, the refund of contributions to former retirement system members, and the cost of administering the retirement systems. Benefit payments to members include both pension and annuity benefits. Expenses for the management of trust funds are incurred by the Washington State Investment Board and funded from earnings on investments. The main deductions for the deferred compensation plan include refunds paid to plan participants and administrative expenses. Total deductions to the retirement trust funds and the deferred compensation plan for Fiscal Year 2004 were \$2,175.2 million, a decrease of \$477.7 million from Fiscal Year 2003. The following schedule is a summary of the deductions to the pension trust funds for the years ended June 30, 2004, and June 30, 2003.

(dollars in millions)		
<b>Deductions to</b>	<b>Fiscal Year</b>	<b>Fiscal Year</b>
<b>Plan Net Assets</b>	<b>2004</b>	<b>2003</b>
Benefits	\$1,940.6	\$1,855.4
Refunds of Contributions	183.9	154.1
Transfers to Pension Plans	25.4	614.6
Administrative Expenses	25.3	28.8
<b>Total</b>	<b>\$2,175.2</b>	<b>\$2,652.9</b>

The decrease in total pension trust fund deductions resulted primarily from a decrease in transfers between pension plans. The decrease in transfers between pension plans was largely due to the implementation of PERS Plan 3 in Fiscal Year 2003 which did not affect Fiscal Year 2004. The increases and decreases between current year and prior year deductions are discussed in more detail in the Management's Discussion and Analysis, which is presented on pages 28-32 in the Financial Section of this report.

Fiscal Year 2004 Pension Trust Fund Deductions by Type



### Funding

The goal of pension funding is to accumulate enough money during a member's working career to pay retirement benefits after the member retires. Measurements of funding status indicate how well a retirement plan is accomplishing that goal. There are two standard indicators of funding status: the funding ratio and the existence of an unfunded liability. Both measure the benefit obligations, or liabilities, of a plan against its assets. If the funding level is adequate, the ratio of total accumulated assets to total liabilities will be larger and more funds will be available for investment purposes. Also, an adequate funding level gives the participants assurance that their pension benefits are secure.

The actuarial value of assets available as of the latest actuarial date for all systems was \$43,869 million. The accrued liability is \$47,130 million. The accrued liability exceeds the net actuarial value of assets available for benefits by \$3,261 million. The ratio of assets to liabilities is 93 percent compared to 96 percent last year. Current contribution rates remain in keeping with the goal of attaining a funding ratio of 100 percent by the amortization dates applicable to each plan (June 30, 2024, or earlier), as required by chapter 41.45 RCW. Valuations are performed for all DRS-administered retirement systems on a yearly (October 1 to September 30) basis. These calculations are prepared by the Office of the State Actuary and reflect the latest valuation results. Additional actuarial information is included in the Actuarial Section of this report.

### Investments

The Washington State Investment Board (WSIB) has sole

authority and responsibility for the investment of all state and local pension fund assets. The enabling statute requires the WSIB to "... establish investment policies and procedures designed exclusively to maximize return at a prudent level of risk." The policies adopted by the WSIB include provisions for the setting of strategic asset allocation objectives, as well as strategies and return objectives for individual asset classes. A summary of the asset allocation can be found in the Investment Section of this report. For Fiscal Year 2004, the commingled trust fund (CTF) investments provided a 16.06 percent rate of return. The CTF annualized rate of return over the last three years was 4.21 percent and 3.97 percent over the last five years. The day-to-day management of pension fund assets is the responsibility of WSIB staff. Further investment information is included in the Investment Section of this report.

### Departmental Initiatives

The department's activities are highlighted in the Introductory Section of this report under the heading "Overview of Agency Operations."

### Independent Audit

An audit of DRS' basic financial statements was conducted by Peterson Sullivan PLLC, independent auditors. The independent auditor's report on our financial statements is included in the Financial Section of this report.

### Awards

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to DRS for its comprehensive annual financial report for the fiscal year ended June 30, 2003. This was the tenth consecutive year that DRS has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current comprehensive annual

financial report continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

In November 2004, DRS also received the Public Pension Standards 2004 Award from the Public Pension Coordinating Council (PPCC). The PPCC is a coalition of three national associations, serving public pension funds, that represents substantially all employees of state and local government in the United States. Eligibility for this award entails meeting the professional standards for plan design and administration set forth in the Public Pension Standards. These standards are intended to reflect minimum expectations for public retirement system management and administration.

### **Acknowledgments**

This report was made possible by the staff of DRS based in part on information provided by the Office of the State Actuary, the Office of Financial Management, and the Washington State Investment Board. Each member of these agencies has our sincere appreciation for the contributions made in the preparation of this report. The report will be provided to the Governor, the members of the Select Committee on Pension Policy, the members of the DRS Advisory Committee, and other interested parties.

This report is intended to provide complete and reliable information that can be used to make management decisions, determine compliance with legal provisions, and evaluate responsible stewardship of DRS-administered retirement system funds.

A handwritten signature in black ink, appearing to read 'John F. Charles', with a long, sweeping horizontal line extending to the right.

John F. Charles  
Director

# Certificate of Achievement

## Certificate of Achievement for Excellence in Financial Reporting

Presented to

### Washington State Department of Retirement Systems

For its Comprehensive Annual  
Financial Report  
for the Fiscal Year Ended  
June 30, 2003

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



President

Executive Director



**Public Pension Coordinating Council  
Public Pension Standards  
2004 Award**

Presented to

**Washington State Department of Retirement Systems**

In recognition of meeting professional standards for  
plan design and administration as  
set forth in the Public Pension Standards.

*Presented by the Public Pension Coordinating Council, a confederation of*

National Association of State Retirement Administrators (NASRA)  
National Conference on Public Employee Retirement Systems (NCPERS)  
National Council on Teacher Retirement (NCTR)

A handwritten signature in cursive script, reading 'Alan H. Winkle'.

Alan H. Winkle  
Program Administrator